DP/2011/28

United Nations

Executive Board of the United Nations Development Programme, the United Nations Population Fund and the United Nations Office for Project Services

Distr.: General
7 April 2011

Original: English

**Annual session 2011**
6 June to 17 June 2011, New York
Item 7 of the provisional agenda
**United Nations Capital Development Fund**

# Report on results achieved by the United Nations Capital Development Fund in 2010

*Summary*

The United Nations Capital Development Fund (UNCDF) works to reduce poverty in the least developed countries by increasing access to microfinance and strengthening local investment. The present annual report details the programme, management and financial performance of UNCDF in 2010.

UNCDF provided support to 37 of the 48 least developed countries in 2010, with a particular focus on post-crisis countries. Local development programmes accounted for 66 per cent of programme delivery; microfinance programmes for 34 per cent. The majority of programme resources went to Africa, followed by the Asia-Pacific region.

The 2010 programme targets were largely met in both practice areas. An enhanced programme of evaluations during the course of the year confirmed the overall effectiveness of UNCDF work in local development and microfinance, and pointed to areas in need of strengthening.

Project 2010, an internal strengthening process started in 2008, was completed, with 82 per cent of the recommendations of a 2009 audit fully implemented. Total contributions to UNCDF increased from $36.2 in 2009 to $42.3 million in 2010. There was a decrease in core funding and an increase in other resources, and an overall greater diversity of funding sources. Programme expenditures for 2010 totalled $43.9 million, up from $41.5 million in 2009.

UNCDF will seek to increase the effectiveness of its support to the least developed countries in 2011 and beyond, by developing new products, building new strategic partnerships and continuing to improve its performance.

11-29370 (E) 200411

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# I. Introduction

1. UNCDF creates new opportunities for poor people and their communities by increasing access to microfinance and investment capital. UNCDF programmes help to empower women. The programmes are designed to catalyze larger capital flows from the private sector, national governments and development partners, with the objective of providing maximal support for the achievement of the Millennium Development Goals.

2. UNCDF programmes are designed to reduce extreme poverty and hunger (Millennium Development Goal 1) and to promote gender equality (Millennium Development Goal 3). In 2010 UNCDF provided support for microfinance and local investment in least developed countries (LDCs) throughout Africa and Asia, as well as in the Arab States and Haiti. (Haiti is the only least developed country in the Western Hemisphere). Local development programmes accounted for 66 per cent of 2010 programme delivery and microfinance for 34 per cent. Overall, 58 per cent of the programme delivery of UNCDP was in Africa, 35 per cent in Asia, and 7 per cent in the Arab States and Haiti.

3. Overall, 2010 proved a solid year for UNCDF. Despite a difficult external environment — donor countries facing severe fiscal constraints, least developed countries grappling with new and growing challenges – UNDCF managed to increase its overall resource base and to develop new interventions in response to country-level demand from least developed countries.

4. Highlights of 2010 included a Special Projects Implementation Review Exercise (SPIRE), under which UNCDF commissioned nine full evaluations in 2010, compared with two evaluations and several case studies in 2009. The objective was to develop a more robust evidence base regarding "what works". Findings to date have validated the UNCDF approaches to both local development and microfinance. They have also pointed to areas in need of strengthening, which UNCDF intends to address.

5. Another highlight of 2010 was stepped up UNCDF efforts in the fields of global advocacy and knowledge sharing. UNCDF and UNDP convened the Global Forum on Local Development in Kampala, Uganda, in October. In addition, UNCDF launched several new publications, and, with the support of UNCDF, the United Nations Secretary-General's Special Advocate for Inclusive Finance for Development, Her Royal Highness Princess Máxima of the Netherlands, engaged in a full range of activities around the world.

6. On the management side, 2010 saw the completion of the UNCDF Project 2010, a process of internal strengthening initiated in 2008. The project included the implementation of 22 far-reaching recommendations from an audit carried out in 2009. A follow-up audit conducted in October 2010 found that UNCDF had made "substantial" progress, achieving an overall implementation rate of 82 per cent. The follow-up audit made one new recommendation.

7. The financial results for 2010 show a reduction in core contributions because of a substantial cut by a major donor faced with fiscal constraints. All other donors maintained their contributions at 2009 levels despite a challenging financial environment. One donor (Austria) was able to increase its core contribution, and one new donor (United States of America) began contributing to core resources. Non-core income continued to rise with strong diversification and support from entirely new partners such as The MasterCard Foundation.

8. The present annual report documents the UNCDF programmatic, managerial and financial performance in 2010.

# II. Programme results

## A. Performance analysis: local development

9. Public investment is inadequate and inefficient in many least developed countries, especially in rural areas where most poor people still live. UNCDF works to ensure that local capital investment — in schools, irrigation schemes roads, water supply — is sustainable, and responds to the needs of poor communities. The UNCDF approach at the local level helps to advance almost all of the Millennium Development Goals, and achieves increasing impact as it is replicated and brought to scale by larger development partners and national governments.

10. UNCDF local development programmes strive to (i) improve the capacity of local governments to plan, allocate and manage resources; and (ii) ensure that lessons learned at the local level are fed into national policies and can be replicated at scale. In 2010, UNCDF pursued local development programmes in 30 least developed countries: 19 in Africa; 7 in Asia and the Pacific; 3 in the Arab States; and 1 in the Caribbean. These included fragile countries just emerging from armed conflict, through to stable countries with gradually maturing local governance systems.

11. Local development programmes in Eritrea, Sierra Leone, Rwanda, Burundi, Tanzania, Bangladesh and Timor-Leste were evaluated in 2010 as part of the UNCDF SPIRE initiative. Also in 2010, the European Commission, a key partner for UNCDF, evaluated the local development work of UNCDF in Liberia, Bangladesh, the Lao People's Democratic Republic and the Solomon Islands.

### Local Government Capacity and Accountability

12. In order for local investment to be effective and respond to the Millennium Development Goals, local authorities must have the capacity to plan and budget in a participatory manner, and to manage resources transparently. In 2010 UNCDF was largely successful in fostering participatory processes and helping targeted local governments improve their planning, budgeting and implementation capacity across all regions (Outcomes 1 and 2). Illustrative examples are the Solomon Islands, where the local development programmes are in their early stages and where focus has been on introducing processes and tools for participatory planning and training of local officials. In Uganda, where local planning processes are already well-established, UNCDF has provided specialized support in identifying and costing interventions designed to catalyze local economic activity.

13. Improving the implementation capacity of local authorities takes various forms, but generally addresses issues related to procurement and financial administration. Timor-Leste and Lesotho are successful 2010 examples of enhanced procurement processes in which there was open bidding for local contractors and tighter financial management of the investment cycle.

| Local government capacity and accountability | Plan | Actual | Assessment of performance* |
|---|---|---|---|
| Outcome indicator 1: Percentage of target local authorities that, as a result of UNCDF support, have improved their plans and budgets. | 100% | 84% | + |

| | | | |
|---|---|---|---|
| Outcome indicator 2: Percentage of target local governments that, as a result of UNCDF support, have improved their implementation capacity. | 100% | 83% | + |
| Outcome indicator 3: Percentage of target local governments that, as a result of UNCDF support, manage their resources with greater transparency. | 100% | 92% | + |
| Outcome indicator 4: Percentage of target local authorities that, with UNCDF support, have developed and/or executed gender-sensitized budgets and/or investment programmes (indicator based on the Gender Equitable Local Development programme) | 100% | 100% | + |

* Assessment of performance based on figures from yearly programme monitoring and evaluation findings.

14. UNCDF interventions have helped achieve greater transparency in the way targeted local governments manage the public expenditure cycle (Outcome 3). Transparency is measured by the way local authorities apply the rules prescribed by law as they relate to management of and reporting on public expenditure, and also by how they inform their citizens of the decision-making process. Over the period under review, in the targeted local governments, competitive bidding processes were announced openly, usually through community notice boards or on the radio. It was also observed — particularly in Asia and the Pacific — that total costs are increasingly disclosed publicly upon completion of local projects.

15. The gender dimension was included in all the investment plans and budgets of local authorities in the five countries included in the Gender Equitable Local Development (GELD) programme of UNCDF and UN-Women (formerly United Nations Development Fund for Women, UNIFEM). This paved the way for gender-sensitive investments in 2011 (Outcome 4). The direct participation of women in local authorities' decision-making process is promoted in all other UNCDF interventions.

16. Evaluations have shown that UNCDF programmes have been broadly successful in introducing participatory planning and in establishing new techniques and approaches to embed participatory planning in the functioning of local governments. Poor communities highly appreciate being directly consulted and involved in the decision-making processes. There seems also to be a strong "value for money" case for empowering people at the local level to make investment decisions. Doing so in one instance was seen to have reduced the cost of capital projects by more than 50 per cent, with no discernable drop in quality.

17. On the other hand, the 2010 evaluations pointed to the following challenges:

(i) capacities of targeted local authorities to undertake operations and maintenance activities remain weak and is often neglected;

(ii) initial baseline data required for effective decision-making is not always available and capacities for realistic target setting and reporting by local authorities can be improved;

(iii) key constraints to enhanced performance remain outside the local authorities' control, affecting the planning and budgeting process; for example, in some situations, the local authorities do not receive timely information on annual fiscal allocations; and

(iv) more proactive gender strategies and budgets are needed to secure the rights of women and improve their access to power.

18. UNCDF will address these challenges. The lack of adequate budgeting for operations and maintenance is a perennial issue. UNCDF will redouble its efforts to ensure that local authorities include maintenance costs in their recurrent budgets. UNCDF will also invest more in helping local authorities establish appropriate baselines and targets, and will strengthen the monitoring function to ensure the collection of reliable data. Greater attention will be given to district coordination, and UNCDF will engage national policymakers to address the disconnect between the planning cycles of local governments and those of sectoral ministries. Lastly, the results from the GELD programme will inform the development of gender-sensitive strategies and budgets for use elsewhere in UNCDF local development work.

**Policy impact, upscaling and replication**

19. A key success criterion for UNCDF programmes is how other partners and governments adopt and replicate on a larger scale approaches, instruments and systems that UNCDF has helped to develop and refine at the local level (Outcomes 6 and 7; note that the results for Outcome 6 are cumulative over five years.).

20. Over the past number of years, all target programme countries have adopted or mainstreamed public-expenditure, management-related procedures and other innovations for national use. Some of these countries have also developed or amended policy, legislative, regulatory and/or monitoring and evaluation frameworks. In 2010 in Timor-Leste, for instance, the Local Government Support Programme was upscaled by the Government from the initial eight pilot districts to all 13 districts in the country.

| Policy impact, upscaling and replication | Plan | Actual | Assessment of performance |
|---|---|---|---|
| Outcome indicator 6: Number of countries where governments officially: (a) adopt/mainstream public-expenditure, management-related procedures and other innovations for national use; and/or (b) develop/amend policy, legislative, regulatory and/or monitoring and evaluation frameworks. | 22 | 23 | + |
| Outcome indicator 7: Number of countries where development partners adopt UNCDF-supported local development approaches, tools or innovations in their own programmes | 22 | 15 | ▲ |

21. In 2010 UNCDF continued to contribute to policy and legal reform processes in partnership with UNDP and other development partners. For example, in Bangladesh, a joint UNCDF-UNDP programme helped the Government to draft regulatory instruments for planning and budgeting in Union Parishads (one of the three tiers of Bangladeshi subnational government). These instruments are now applied nationwide. In Bhutan, a formula-based grant system was brought to scale nationwide. In Liberia, budgeting, public financial management and procurement procedures for local authorities — the formulation of which were supported by UNCDF — have been adopted by national authorities.

22. Despite the solid recent record of positively influencing policy development, important challenges remain. Decentralization and true empowerment of the local level is an inherently political process. UNCDF has found in some cases that a strong commitment by national authorities to empowering the local level can change as circumstances change (e.g. opposition party gains strength at the local government level). In addition, political instability and reaction to natural disasters can lead to some "recentralization". In Yemen, even before the difficulties of early 2011, the formulation of a national programme to implement the local governance strategy (approved by the Cabinet in 2008) had stalled, largely because of the increasingly fragile political and security situation. Transitioning from national policy reform to actual policy adoption by local authorities is also sometimes challenging. In Rwanda the public-expenditure management guidelines enacted by national authorities still have to be rolled out to local governments for implementation. UNCDF will address this gap in 2011 by developing manuals and training material that are needed by the central government to implement the roll-out.

23. Overall, however, the partnership between UNCDF and UNDP vigorously promotes policy development. UNDP has a long track record of bringing state and non-state actors together to address critical human-development policy issues, and UNCDF has extensive experience in the area of fiscal decentralization. (See the Evaluation of UNDP contribution to strengthening local governance and the management response thereto: http://www.undp.org/evaluation/thematic/lg.shtml). The 2010 SPIRE exercise found that UNCDF contributions to national policy debates were recognized and appreciated. Where the policy impact has not been as significant as hoped, the SPIRE evaluations suggest that UNCDF needs to do a better job at communicating programme results, and at advocating for change together with its partners. This is an area that UNCDF will pursue actively in 2011 and beyond.

24. Having its work replicated is a key measure of UNCDF success in local development. In 2010, in 68 per cent of target programme countries (Outcome 7) development partners adopted UNCDF-supported local development approaches, tools or innovations in their own programmes. In Bangladesh, the World Bank and the Government started formulating the next phase of the UNCDF/UNDP-supported Local Governance Support Project by incorporating many of the UNCDF/UNDP approaches and tools in areas such as fiscal transfers, local accountability and participatory processes. In Mali, the Local Authorities Financial and Institutional Management System, developed in-house by UNCDF, will be piloted by the African Development Bank in five regions.

## B. Performance analysis: inclusive finance/microfinance

25. Ninety percent of people lack access to formal financial systems in the least developed countries. The UNCDF ability (unique in the United Nations system) to provide grants and loans directly to the private sector helps bring microfinance to underserved markets. This has a direct impact on the achievement of Millennium Development Goal 1 (poverty) and Millennium Development Goal 3 (gender). UNCDF ranks at the very top of the SmartAid for Microfinance Index, which measures aid effectiveness.

26. UNCDF pursues an "inclusive finance" approach, which is designed to ensure that a range of financial products — savings, credit, insurance, payments, remittances — are available to all segments of society, at a reasonable cost and on a sustainable basis. Within a given least developed country, UNCDF begins with a sector assessment of opportunities and constraints at the macro-level (policy),

meso-level (support infrastructure) and retail level (financial service provider). This assessment is combined with a gap analysis of areas not supported by other development partners. This leads to a tailored programme of support designed to seize opportunities, remove constraints and fill gaps to build an inclusive financial sector.

27. In 2010, UNCDF supported inclusive finance sector programmes in 24 least developed countries: 15 in sub-Saharan Africa, 8 in Asia (with 5 least developed countries covered by a joint UNDP/UNCDF regional programme for Pacific Islands), and 1 in the Arab States. Ten of the least developed countries currently supported are post-conflict countries. In addition, in 2010 UNCDF supported UNDP inclusive finance activities in 14 countries where UNCDF did not have its own programmes. These included 13 countries that are not among the least developed countries.

28. The number of financial service providers supported by UNCDF increased in 2010 from 65 to 85, as new country programmes became fully operational. In addition, two mobile network operators were supported via the Pacific Islands programme.

29. The year 2010 also saw significant growth in UNCDF global microfinance programmes. These new programmes complement existing UNCDF national sector programmes, and bring additional resources to the least developed countries. In addition, 2010 saw increased advocacy by UNCDF, and a greater focus on savings-led institutions and client protection, in answer to the repayment crises that kept microfinance in the headlines for much of the year.

30. In all of its work UNCDF strives to (i) increase access to financial services, including by leveraging its own investments and working with other partners; (ii) increase the sustainability of the financial service providers it supports; and (iii) strengthen the overall policy and institutional environment.

### Improved access to financial services

31. The growth from 2004 to 2010 in clients served by UNCDF-supported financial service providers is shown below.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Number of active clients | 379,018 | 438,272 | 616,035 | 1,171,306 | 1,768,931 | 2,550,565 | 3,511,723 |

32. UNCDF is well on target to reach its goal of serving 6 million active clients by 2013 through the financial service providers in which it invests. A 24 per cent compounded annual growth in client outreach is needed to achieve that result, and UNCDF was able to exceed that growth rate in 2010. Of these clients, 65 per cent of the borrowers were women. Thus UNCDF exceeded the global target: at least 50 per cent of clients should be women. Given that households on average comprise five persons, this represents an impact on the lives of some 17.6 million persons.

| Improved access to financial services | Plan | Actual | Assessment of performance |
|---|---|---|---|
| Outcome indicator 1: Extent to which financial service providers are | 3,100,000 | 3,511,723 | + |

| | | | |
|---|---|---|---|
| improving their client outreach | | | |
| Outcome indicator 2: Net change in value of loan portfolio of the financial service provider/Total UNCDF core contributions | 10 to 1 | 18 to 1 | + |
| Outcome indicator 3: Net change in value of savings portfolio of the financial service provider/Total UNCDF core contributions | 10 to 1 | 11 to 1 | + |

33. The ability of UNCDF to exceed its 2010 target for the number of active clients (Outcome 1) came primarily from the rapid growth (362,749 clients in the period of a few months) in branchless banking clients from the Pacific Financial Inclusion Programme, which is jointly supported by AusAID, the African, Caribbean and Pacific States initiative of the European Union, UNCDF and UNDP. This promising programme, which is pioneering both government-to-people payments and cellphone banking in the Pacific, underwent a midterm evaluation in 2010, as part of the SPIRE initiative. The evaluation found that while it was too early to judge the sustainability of the new services, to date the programme had been "catalytically central to the major developments in the sector, facilitating and coordinating a comprehensive and cohesive sector agenda".

34. In all of its interventions UNCDF strives to be catalytic, including by leveraging additional stakeholder resources within its programming frameworks. For every dollar that UNCDF invests in its microfinance programmes, other partners currently invest 3.8. This is a considerable level of engagement in UNCDF-designed interventions. UNCDF aims to raise this leverage ratio to 5 by 2013.

35. UNCDF investment of its core resources in financial service providers allowed these institutions in 2010 to improve the value of their loan and savings portfolio dramatically, and significantly more than anticipated (Outcome 2 and 3). This was in part because of MicroLead, the UNCDF $26 million flagship global microfinance programme that has significantly boosted the value of the savings portfolio of target financial service providers. The programme, which is supported by the Bill & Melinda Gates Foundation, has awarded 10 grants worth $17.6 million to Southern-based market leaders so that they can enter least developed countries with savings-led methodologies. UNCDF plans to expand the programme in 2011. The initial programme investment of $7.9 million of UNCDF core resources is projected to reach 815,000 depositors and 732,000 borrowers by the end of 2013.

36. While the target for the loan portfolio was also exceeded, results may decrease over time as some financial service providers fail to fully meet the targets of the performance based agreements they sign as a condition of UNCDF funding. UNCDF will monitor both the savings and the loan indicators carefully, given the challenge that a rapid growth rate in microfinance brings, and will adjust targets as necessary.

**Sustainability of financial service providers**

37. The sustainability of the financial service providers that UNCDF invests in is captured via indicators that focus on profitability, portfolio quality and transparency (Outcomes 4 through 6).

| Sustainability of financial service providers | Plan | Actual | Assessment of performance |
|---|---|---|---|
| Outcome indicator 4: Extent to which financial service providers are improving their sustainability (profitability) | 80% | 64% | ± |
| Outcome indicator 5: Extent to which financial service providers are improving their portfolio quality | 80% | 56% | ± |
| Outcome indicator 6: Financial service providers have audited financial statements (transparency) | >95% | 99% | + |

38. Sixty-four percent (64 per cent) of the financial service providers supported by UNCDF managed to improve their profitability, and 56 per cent met targets for the quality of their portfolio. The risky and difficult environment in which UNCDF operates explains the performance target of 80 per cent and the moderate results achieved in 2010. The high standard (less than 5 per cent of portfolio at risk) set in UNCDF performance based agreements is also very challenging for many relatively new financial service providers. The disruptions and uncertain environments in many of the post-conflict least developed countries where UNCDF works also contributes to the difficulty of fully meeting this target. In addition, the impact on local economies of the global financial crisis has affected both the profitability and portfolio quality of many financial service providers globally.

39. The compliance rate for financial service providers with audited financials increased from 92 per cent in 2009 to 99 per cent in 2010, with funding suspended for non-complying financial service providers.

**Policy impact, upscaling and replication**

40. While expanded access to financial services helps reduce poverty and contributes to growth, the quality of that access matters. A sound policy framework is essential, but is incomplete without a proactive industry and farsighted financial services providers. By getting involved in issues related to client protection at an early stage in least developed countries, UNCDF is working to avoid the over-indebtedness crises that beset the industry in countries such as Bosnia and Herzegovina, Morocco, Nicaragua and India (Andhra Pradesh). To promote expanded access to responsible finance, UNCDF works at all three levels (macro/policy, meso/industry and micro/retail), championing, in particular, the Client Protection Principles of the Smart Campaign. In 2010, UNCDF began to operationalize these principles with the goal of achieving more than 80 per cent coverage by 2013.

| Policy impact, upscaling and replication | Plan | Actual | Assessment of performance |
|---|---|---|---|
| Outcome indicator 7: Extent to which national policy environment is improved for client protection | 25% | 38% | + |
| *Outcome indicator 8: Ability of* | 25% | 21% | + |

| | | | |
|---|---|---|---|
| networks and associations to provide advocacy (e.g. client protection) to financial service providers | | | |
| Outcome indicator 9: Extent to which financial service providers are engaged (e.g. in client protection) | 10% | 6% | ± |
| Outcome indicator 10: Extent to which donors support UNCDF financial systems approach | >66% | 49% | ± |

41. UNCDF works with financial services providers and industry associations to raise awareness, support certification and build capacity in order to operationalize the Client Protection Principles. Of the country-level networks with which UNCDF partners, 21 per cent engaged in some client protection activities in 2010. In Malawi, for example, the UNCDF-UNDP joint programme facilitated a stakeholders meeting that resulted in the establishment of national and technical committees to oversee the development and implementation of a national framework for financial literacy and consumer protection, championed by the Reserve Bank of Malawi.

42. Client protection will only be effective if those providing the services directly to clients: design their products and services to meet the needs of clients, provide these products and services in a transparent and ethical manner, and ensure that their clients are equipped to make good decisions about their use. In October 2010, UNCDF changed its standard performance based agreement with financial service providers to include endorsement of the Client Protection Principles. Six per cent of financial service providers have already endorsed these principles. The target of 10 per cent was not reached because of the relatively late introduction of the requirement in 2010 and the initial focus at the network level. A series of engagements are planned for 2011 in order to boost the endorsement and implementation of these principles.

43. Development efforts are enhanced when there is a shared vision among stakeholders and harmonized support for common goals. UNCDF works with other development partners at the global and country levels to align programmes and messages. At the country level, investment committees review new initiatives, and they coordinate and even pool country-level funding. Forty-nine per cent of donors participated in these investment committees in 2010 (as compared to the plan of 66 per cent). In Senegal, UNCDF has been particularly effective, bringing 80 per cent of the donors into the investment committee. As a result, UNCDF has been able to successfully support the implementation of the national microfinance strategy with appropriate resources and technical inputs.

44. At the policy level, UNCDF supports evidenced-based regulation that balances access and protection and that emphasizes disclosure and transparency. As UNCDF takes an approach that addresses the specific key constraints impeding access to financial services in any given country, there are no predetermined targets for this indicator. UNCDF looks for opportunities to make a difference at the policy level and then tracks the results of its interventions. In the West African Monetary Union, for example, UNCDF and other development partners consulted with the Central Bank of West African States during the formulation of prudential guidelines and regulations for microfinance. In Liberia, UNCDF helped move forward the passage of a microfinance deposit-taking act. Based on stronger diagnostics that will be available with the launch in 2011 of a new sector

assessment tool, UNCDF will review whether annual targets for policy impacts could be set.

## III. UNCDF and the Millennium Development Goals

45. The Millennium Development Goals lie at the core of the mission of UNCDF. They are the foundation of UNCDF programmatic work with both the public sector (local development) and the private sector (microfinance). They inform UNCDF advocacy. They shape the way UNCDF responds to new kinds of demand from its partner countries.

46. UNCDF local development work targets the local authorities that are typically tasked with delivering services critical for achieving the Millennium Development Goals (see Figure 1). By strengthening the planning and implementation capacity of target local authorities and designing transparent and effective transfer mechanisms for channelling capital to the local level — and then using UNCDF capital to "prime the pump" — UNCDF helps to increase the flow of capital into investments that promote the achievement of Millennium Development Goals in pilot districts.

**Figure 1. Relationship between service delivery functions commonly assigned to the local government level and the Millennium Development Goals**

| MDG | Primary education | Primary health | Agricultural extension | Water and sanitation | Roads | Solid waste mgmt. | Fire fighting and police | Land use planning* | Economic development* |
|---|---|---|---|---|---|---|---|---|---|
| 1. Poverty and hunger | ■■ | ■■ | ■■■ | ■■ | ■■ | ▪ | ■■ | ■■ | ■■ |
| 2. Primary education | ■■■ | ▪ | ▪ | ▪ | ▪ | | | ▪ | |
| 3. Gender equality | ■■ | | ▪ | | | | ■■ | | |
| 4. Child mortality | ■■ | ■■■ | ▪ | ■■ | ■■ | ■■ | | ▪ | |
| 5. Maternal health | ▪ | ■■■ | ■■ | ■■ | ■■ | ▪ | ▪ | | |
| 6. HIV/AIDS and malaria | ▪ | ■■■ | ▪ | ■■ | | ■■ | | ▪ | |
| 7. Environmental protection | ▪ | ▪ | ▪ | ■■■ | ■■■ | ■■■ | ▪ | ■■■ | ▪ |
| 8. Partnership | | | | | | | | | ▪ |

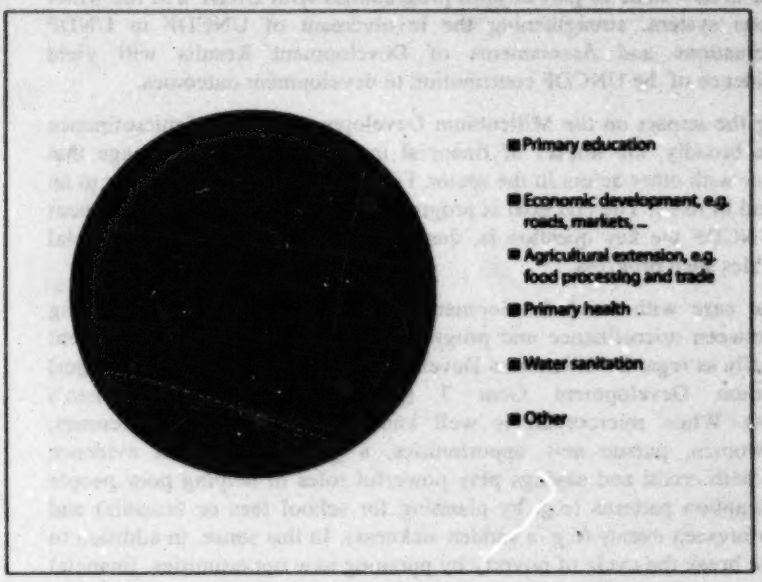
*Key:* ■■■ direct provision ■■ indirect relationship ▪ some relationship

*Note: * In some cases, local governments can influence the Millenium Development Goals negatively through poor governance*

*Source: Based on Improving Local Government: the Commonwealth vision, Commonwealth Local Government Forum, 2009*

47. More capital at the local level translates into more, and more cost-effective, schools, clinics and water systems, all of which are critical to progress on the Millennium Development Goals. It also means improvements in the capital infrastructure — covered markets, irrigation schemes, feeder roads — critical for developing local economies (see pie chart below) and reducing poverty and hunger.

**Figure 2. Use of 2010 UNCDF grants for investments related to the Millennium Development Goals**




48. The role of UNCDF in stimulating additional local-level investments that promote the achievement of Millennium Development Goals — and in increasing the efficiency, cost-effectiveness and sustainability of the local initiatives — has yet greater impact when these efforts are replicated on a national scale by governments and larger development partners. This has been the case over time in countries such as Senegal, Uganda, Malawi, Mozambique, Uganda, Tanzania, Bangladesh and Cambodia. More recently, there has been progress in Puntland, in Somalia, where the authorities have decided to allocate 10 per cent of their national budgets to local-level investments. Similarly, the Government of Timor-Leste has recently decided to channel substantial new oil revenues to the local level via systems set up by UNCDF and its partners.

49. While a strong case can therefore be made for the relevance of UNCDF local-development work to the Millennium Development Goals, measuring the exact contribution of UNCDF at the level of outcomes for individuals and communities is more challenging. The recent SPIRE initiative highlighted anecdotal evidence that new infrastructure — an output of UNCDF programmes — is greatly valued by the people in various communities (and that the people also greatly appreciate having been consulted on regarding this infrastructure). Further, external evaluations by the European Commission in 2010 gave generally strong marks to the local work by UNCDF in the Solomon Islands, Bangladesh, Liberia and the Lao People's Democratic Republic, including to the relevance and likely impact of this work on poverty reduction.

50. But accurately measuring changes in lives, especially over time, would require additional efforts to establish baselines at the beginnings of projects, as well as closer monitoring. There are also the challenges of attribution — of proving that any measurable improvement in a person's life came about as a direct result of a given capital investment (as opposed to something else) – as well as of time frame. The impact on health of a new water system or clinic may not be immediately

apparent. UNCDF is nonetheless currently exploring how it can cost effectively meet Millennium Development Goal measurement challenges. Since almost all UNCDF work is now done as part of joint programmes with UNDP and the wider United Nations system, strengthening the involvement of UNCDF in UNDP outcome evaluations and Assessments of Development Results will yield additional evidence of the UNCDF contribution to development outcomes.

51. Assessing the impact on the Millennium Development Goals of microfinance — and, more broadly, the impact of financial inclusion — is a challenge that UNCDF shares with other actors in the sector. Financial inclusion is a means to an end, not an end in itself. The end goal is progress on the Millennium Development Goals. For UNCDF the key question is, therefore, the extent to which financial inclusion enables such progress.

52. As is the case with local development, there would seem a very strong correlation between microfinance and progress on the Millennium Development Goals, especially as regards Millennium Development Goal 1 (poverty and hunger) and Millennium Development Goal 3 (gender equality and women's empowerment). While microcredit is well known for helping entrepreneurs, particularly women, pursue new opportunities, a growing body of evidence suggests that both credit and savings play powerful roles in helping poor people smooth consumption patterns (e.g. by planning for school fees or funerals) and respond to unforeseen events (e.g. a sudden sickness). In this sense, in addition to helping people break the cycle of poverty by pursuing new opportunities, financial inclusion appears to play a quite equally significant role in helping poor people avoid falling back into poverty.

53. In a larger sense, studies have shown that better access to finance not only increases economic growth, but also helps to fight poverty, by reducing income gaps between rich and poor people.[1] Recent impact studies[2] of savings accounts demonstrate that access to a savings account has had a substantial, positive impact on levels of productive investments among women, and, within 6 months, led to higher income levels (using expenditure as a proxy). In addition, anecdotal evidence abounds regarding the positive effects: of teachers receiving their salaries electronically and therefore being able to stay in the classroom instead of travelling to pick up cash payments; of poor people in rural areas having higher disposable incomes because technology is driving down the costs of receiving remittances; of new credit products enabling poor people and small businesses to purchase products that make use of new technology. Products such as cook stoves and solar panels lead to improved health and environmental outcomes and also reduce the 20-30 per cent of annual income previously spent on off-grid energy.

54. Yet more still needs to be done to determine the lasting impact of microfinance on individuals and communities over time. In the view of UNCDF and other organizations, assessments to date have tended to be based on time frames that are too short (e.g. 18 months) for determining the true, sustainable impact of interventions. The recent negative publicity concerning microfinance in several countries has made the imperative of better impact assessment all the more urgent.

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[1] See "Finance for All? Policies and Pitfalls in Expanding Access", World Bank, 2007, http://www.worldbank.org/financeforall and "Reaching out: Access to and use of banking services across countries", World Bank, September 2005.

[2] See "Savings Constraints and Microenterprise Development: Evidence from a Field Experiment in Kenya", 2011, http://www.econ.ucla.edu/pdupas/SavingsConstraints.pdf.

55. UNCDF will continue to measure its performance in terms of improving sustainable access to microfinance for poor people and small businesses. At the same time, it will continue working with its partners in the Consultative Group to Assist the Poor (CGAP) to strengthen the ways in which the impact of microfinance on people and communities can be measured, and it will apply best measurement practices to its programmes as those practices become apparent.

## IV. Partnerships, global advocacy and knowledge sharing in 2010

56. Partnerships, advocacy and knowledge sharing are central to the UNCDF agenda and business model, and allow it to have an impact well beyond its relatively modest financial resources. They are central to the mandate of UNCDF and to its overall effectiveness in the evolving "One UN" context.

57. The UNCDF strategic partnership with UNDP continued to strengthen in 2010. All UNCDF country programmes in both local development and microfinance are now joint UNCDF/UNDP programmes, and UNCDF provides, on demand, policy and technical advice in both of its practice areas in non-least developed countries on behalf of UNDP. Together with UNDP, UNCDF is committed to implementing commitments made in response to the 2010 evaluation of the UNDP contribution to strengthening local governance.

58. In operational terms, an almost complete integration of UNCDF and UNDP operational procedures, policies and systems has now been achieved, paving the way for even more effective joint programmatic activity at country, regional and global levels. In late 2010 UNCDF finalized an implementation plan for the rationalization of its country-level presence, including a renewed level of engagement with UNDP. The goal is to ensure that the resources of both organizations are allocated as strategically as possible.

59. In 2010 UNCDF entered into formal partnerships with the Swedish International Center for Local Democracy and The Hague Academy for Local Governance: two institutions that support innovative training for officials in the least developed countries. In microfinance, the major new partnership of 2010 was with the MasterCard Foundation, in support of a new programme, YouthStart, which is intended to increase access by young people, particularly young women, to financial services in sub-Saharan Africa. Studies show that access to financial services, in particular the ability to open savings accounts, when combined with financial literacy and leadership training, can lead to improved livelihoods for individuals and their families.

60. UNCDF also stepped up its global advocacy activities in 2010. Together with UNDP it convened the first Global Forum on Local Development, in Kampala, to look at the steps necessary to unleash the potential of local governments to promote the achievement of the Millennium Development Goals (www.uncdf.org/gfld). More than 600 delegates from 81 countries participated, and there was broad support for pursuing the agenda in a variety of complementary forums. On the microfinance side, UNCDF continued to support the United Nations Secretary-General's Special Advocate for Inclusive Finance for Development, Her Royal Highness Princess Máxima of the Netherlands, and to host her United Nations secretariat. In 2010 the Special Advocate played an influential role in a growing spectrum of inclusive finance issues, both at the

country level (e.g. Rwanda, Kenya and Liberia) and in global forums (United Nations, G20, World Bank/International Monetary Fund)[3]

61. UNCDF publications in 2010 included:

(i) *Performance-Based Grant Systems—Concepts and International Experience*, which documents the experiences of UNCDF, often in collaboration with the World Bank, the Asian Development Bank and others, in designing and implementing innovative local government grant systems.

(ii) *Local Development Outlook*, a pilot volume looking at the prospects for local development in Cambodia, initiatives which could be easily replicated elsewhere.

(iii) A discussion note on *Local Governance and Climate Change*, prepared in partnership with UNDP.

(iv) A joint publication with the Organisation for Economic Co-operation and Development (OECD): *The United Nations Capital Development Fund (UNCDF) in West Africa.* UNCDF also collaborated with the Commonwealth Local Government Forum and UNDP on a study on the status of local governance in Eastern Africa.

## V. Management results

62. The year 2010 saw the successful completion of UNCDF Project 2010, which was initiated in 2008. This process of internal strengthening had far-reaching implications on the organization's structure and policies. The following measures were implemented: (i) the establishment of a Corporate Management Plan and a multi-year planning framework setting overall priorities and performance targets; (ii) a new organizational structure with streamlined regional entities and better defined reporting lines and accountabilities; (iii) a formal system for the delegation of authority; (iv) a codification of implementation modalities for UNCDF grants; (v) more robust monitoring and oversight mechanisms. UNCDF also issued several new strategies and policy documents in 2010 including: a revised operations manual, a learning strategy and a knowledge management strategy, a document management and classification policy and a policy on travel.

63. An on-site follow-up audit conducted from 11 to 20 October 2010 found that UNCDF had made "significant progress" in addressing weaknesses identified in the earlier 2009 audit, having implemented 82 percent of the 24 recommendations due by that time. One new recommendation was raised and is being addressed.

64. The table below summarizes UNCDF management results for 2010.

**Table 1. 2010 management results**

| | | | | | |
|---|---|---|---|---|---|
| Client satisfaction | Relevant programming on LDCs, including post-conflict LDCs | LDCs with UNCDF programmes | 40 LDCs | 37 LDCs | 37 LDCs |

[3] See http://www.uncdf.org/english/microfinance/uploads/project_annual_review/UNSGSA%20AR%20final%20low-res%20rev%20130910.pdf

| | | | | | |
|---|---|---|---|---|---|
| | Improve strategic partnership with UNDP and the rest of the United Nations system | UNDP country office satisfaction with timeliness and relevance of UNCDF services in its respective practice lines | 60.6% | 70% | * |
| Internal efficiency | Harmonize UNCDF and UNDP procedures to avoid overlaps and redundancies | UNCDF operations and procedures harmonized with those of UNDP | UNCDF operations manual fully harmonized with UNDP operations | Maximum integration of operational procedures, policies and systems | Achieved |
| | Strengthen United Nations coordination | Percentage of LDCs where UNCDF is active in which contributions are integrated in the United Nations country-level programming framework** | 32 LDCs** | 70% | 70% |
| | Improve efficiency of delivery | Administrative-to-total-expenditure ratio | 15.5% | 15% | 11.1% |
| | Strengthen people management | Staff perception | 68.8% | 75% | *** |
| Internal efficiency | Implementation of the audit recommendations of the Office of Audit and Investigation | | 13 | 22 | 18 |
| Financial resources | Achieve resource mobilization targets | Regular resources mobilized | $19.7 million | $ 20million | $18.5 million**** |
| | | Other resources mobilized | $16.8 million | $20 million | $ 23.8 million |
| | Ensure delivery against plan | Delivery against approved annual spending limits | 78% | 80% | 81% |

* From the Headquarters Products and Services Survey. Survey not available at the time of the report.
** Indicator was refined in 2010 and criteria for integration in United Nations country-level programming frameworks were sharpened.
*** From Global Staff Survey. Survey not available at the time of the report.
**** Includes $3.4 million from UNDP programme funds.

# VII. Financial analysis

65. In spite of continued pressures on development budgets globally in 2010, total contributions to UNCDF resources increased by 16 per cent, from $36.4 million in 2009 to $42.3 million in 2010, including $3.46 million allocated by UNDP to UNCDF programme funding. Also the number of donors and their diversity continued to improve, reaching 29 in 2010 (up from 27 in 2009 and 20 in 2007). Among the five largest donors to UNCDF in 2010, two were private sector

foundations (the Bill & Melinda Gates Foundation and MasterCard Foundation). The remaining top donors are Sweden, Australia and Belgium.

66. Although a healthy sign of continued and more diverse donor support, much of the recent growth has been in earmarked resources, which totalled $23.8 million in 2010. Contributions to 2010 core resources dropped to $15.0 million, from $18.7 million in 2009 (excluding UNDP programming support). The drop was a result of exchange-rate fluctuations and a significant reduction by one major donor because of fiscal constraints. Other core donors maintained their contributions at 2009 levels despite a challenging financial environment. One donor was able to increase its core contribution (Austria), and one new donor (United States of America) began contributing to UNCDF core resources.

67. Total expenditures in 2010 were $49.4 million, roughly equivalent to 2009. UNCDF is watching its expenditure pattern to ensure that it continues to meet outstanding commitments but does not overextend itself, given the decreases registered in core contributions.

68. Fund balances at the end of 2010 were approximately $53.0 million. UNCDF also has operational reserves of approximately $24.6 million for core and extrabudgetary accounts.

**Table 2. Expenditure trends 2003-2009**
(*in millions of dollars*)

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Programme expenditures | 22.9 | 19.2 | 25.2 | 28.7 | 37.0 | 41.5 | 43.9 |
| - of which regular resources | 14.9 | 11.6 | 16.8 | 19.0 | 22.6* | 22.2* | 25.8* |
| - of which other resources | 8.0 | 7.6 | 8.4 | 9.7 | 14.4 | 19.3 | 18.1 |
| UNCDF support | 5.3 | 6.7 | 4.6 | 5.4 | 6.8 | 7.6 | 5.5 |
| Total | 28.2 | 25.9 | 29.8 | 34.1 | 43.8 | 49.1 | 49.4 |

* Expenditures in 2008, 2009 and 2010 include respectively $6 million, $1 million and $3.1 million expended against UNDP programme contributions to UNCDF. 2008 and 2009 also include approximately $4.7 million expended against the UNDP biennial support budget. This number dropped to $4.1 million in 2010.

69. The bulk of UNCDF programme resources continue to go to Africa (see the table below). In 2010, 47 per cent of country programme expenditures went to Africa, followed by Asia and the Pacific at 28 per cent. Africa also accounted for the majority of expenditures on UNCDF global thematic initiatives, which in 2010 accounted for 19 per cent of the total programme expenditures. Expenditures in this category included the flagship MicroLead programme, the Pacific Islands financial inclusion programme, an ILO/UNCDF joint programme on micro-insurance, the Gender Equitable Local Development joint programme with UN-Women, and global advocacy (e.g. the Global Forum on Local Development and support to the United Nations Secretary-General's Special Advocate for Inclusive Finance for Development).

**Table 3. 2010 programme expenditures per region and practice area**
*(in millions of dollars)*

| | | | |
|---|---|---|---|
| Africa | 13.2 | 7.3 | 20.5 |
| Asia and Pacific | 10.0 | 2.1 | 12.2 |
| Arab States | 0.3 | | 0.3 |
| Latin America | 2.0 | | 2.0 |
| Global programmes | 3.1 | 5.2 | 8.3 |
| Research and development | 0.1 | 0.2 | 0.2 |
| Knowledge management | 0.1 | 0.4 | 0.4 |
| Total | 28.8 | 15.1 | 43.9 |

*Source*: Financial statements for UNCDF as of 31 December 2010 before final closing of accounts.

# VII. UNCDF looking forward

70. UNCDF is coming out of a period of significant restructuring and change. Project 2010 has streamlined and strengthened its internal procedures and controls, taking account of its near doubling in size (by income) in the past five years, and positioning it for strong future growth. The UNCDF staff has been significantly renewed, and its partnership with UNDP has become both stronger and more multifaceted. While UNCDF — like all United Nations development agencies — will face a difficult external environment in 2011 and beyond, the growth in its non-core income, including from non-traditional sources, augurs well for the future.

71. Within this context the UNCDF priorities for the future can be grouped under three headings: products, partnerships and performance.

**Products**

72. UNCDF will respond to new kinds of demand from its least developed country partners via new products and approaches. In the area of microfinance these will include:

(i) A new country diagnostic tool on financial inclusion being developed with the FinMark Trust (South Africa) and others. This tool will help all stakeholders — in least developed countries and non-least developed countries alike — to better understand the challenges to financial inclusion in a given country, and to tailor their strategies appropriately.

(ii) A second phase of the flagship MicroLead facility, targeted specifically to sub-Saharan Africa.

(iii) CleanStart, a pilot global facility that will help microfinance institutions in the least developed countries develop financial products that enable poor people and small businesses to purchase off-grid clean energy technologies (e.g. clean cook stoves; micro-solar solutions).

(iv) Branchless banking, an initial attempt to apply elements of the highly innovative Pacific Islands programme (which features government-to-people payments and cellphone banking) to other least developed countries.

73. On the local development side, these new products and approaches will include:

(i) The Local Climate Adaptive Living Facility and the Fiscal Grant Facility, two new investment products being tested in Bhutan. These are designed to help local governments shoulder the extra costs of planning infrastructure that is resilient to climate change and natural disasters.

(ii) Pilot initiatives being tested in four countries (Uganda, Tanzania, Senegal and Sierra Leone) to engage the private sector in attracting new investments and creating new jobs.

(iii) The Local Development Finance Initiative, being piloted in Tanzania, which is designed to develop innovative, private-sector-led ways of financing public infrastructure at the local level.

**Partnerships**

74. UNCDF will continue to build strategic partnerships as the best means of leveraging its technical expertise in local development and microfinance, and of increasing its overall impact.

(i) Local development: UNCDF will explore how to take the successful partnership it enjoys with the World Bank, particularly in Bangladesh, to other countries, with a particular focus on Africa.

(ii) Microfinance: the new diagnostic tool being developed with the FinMark Trust (see above) will help UNCDF to build broad coalitions of actors committed to financial inclusion at the country level. UNCDF will also continue to build new partnerships with non-traditional funders, including private foundations, in the area of financial inclusion.

(iii) Advocacy and knowledge sharing: the new emphasis on partnerships for advocacy and knowledge sharing will continue.

**Performance**

75. UNCDF will continue to strive to improve its performance, particularly at the country level. The SPIRE initiative will continue in 2011. Separately, UNCDF has commissioned an external review of its entire microfinance portfolio. The results of all evaluations and reviews will be posted on the UNCDF website, together with the UNCDF management responses. In the period ahead UNCDF will pay particular attention to:

(i) Setting appropriate baselines and targets for programmes and strengthening monitoring;

(ii) Striving for policy impact in partnership with UNDP;

(iii) Better communication of results through advocacy and knowledge products;

(iv) Strengthening overall project portfolio management;

(v) Implementing strategies designed in 2010.